



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NOT RECEIVED
Reliance to Manager, EO Determinations - Cincinnati

Date:

JUL 26 2001

DATE:

SURNAME

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The reasons for our conclusions are set forth below.

You were incorporated in the State of [REDACTED] on [REDACTED]. You were formed to operate beachboy concessions on property owned by the State of [REDACTED] and the City and County of [REDACTED]. Your purpose is preserving the [REDACTED] beachboy tradition. You are a membership organization. Your members are qualified [REDACTED] appropriately licensed/certified to provide beach-related services under [REDACTED] law.

In an attachment to Form 1023, you state that the City and County of [REDACTED] are preparing to establish a lottery for all non-profit [REDACTED] stands to all qualified participants. You hope that one of these beach concession stands will be awarded to you so that you may start your operations.

You are a membership organization. You now have [REDACTED] members. In accordance with the requirements of the City and County of [REDACTED] each member is a licensed [REDACTED]. You have prospects of adding several more members. No member shall be entitled to vote or have any voice in the management of the corporate affairs per your Bylaws. (Article VII, Bylaws) You are managed by your Board of Directors.

You have eight Directors; [REDACTED] and [REDACTED]. The three [REDACTED] Directors are related to each other. The other Directors are not related to them, or to each other. None of them receive compensation for their role as directors. Director [REDACTED] and Director [REDACTED] will be paid for their services as attorney and CPA for you, respectively.

You state that you will be serving the interests of the State of [REDACTED] by continuing the [REDACTED] tradition, and will thus be serving the community of the City and County of [REDACTED]. There was no state involvement in your creation and no state official appointed any of your board members or participated significantly in planning your activities.

You plan to rent surfboards, body boards, canoes and other water-related equipment. You will also provide surfing and canoeing instructions and other water-related services. Your source of income will be from the rental of beach equipment to the general public. Rental income is expected to be \$[REDACTED] in [REDACTED] and [REDACTED] in [REDACTED]. Expenses are expected to be rent of beach equipment of \$[REDACTED], other salaries and wages of \$[REDACTED], and expenses attributed to activities related to your purposes of \$[REDACTED]. In [REDACTED], expenses are expected to be the same as in [REDACTED] with an additional expense of [REDACTED] for assisting retired or injured former [REDACTED], possibly through assistance with medical costs not covered by medical insurance or on an as needed basis. Once you have satisfied your working capital needs, you expect to spend the remainder of your net income on the needs of retired/injured beachboys. Specifically, the assistance you will offer injured [REDACTED] would be for costs not covered by medical insurance. (i.e., non-reimbursed medical expenses, living expenses, travel to and from hospitals, etc.)

At this time, no one is receiving a salary from you. Generally, the manager of a [REDACTED] concession receives a salary for his efforts. It is estimated that a competitive salary for such a manager would be \$[REDACTED] to \$[REDACTED]/yr. A manager can expect to work 40-60 hours per week. Additionally, one or two clerks are employed that would be paid at the rate of \$[REDACTED] per hour on an as needed basis. As of this date no manager has been chosen. You have told us that it is possible, if not likely, that [REDACTED] your Vice-President and Director, would be chosen as manager based upon his years of experience in the [REDACTED] business ([REDACTED] is a licensed [REDACTED] and a member of your organization.) Thus, he would be paid approximately \$[REDACTED] to \$[REDACTED]/yr.

You will hire [REDACTED] who will work as independent contractors for you. They will be paid compensation for their services rendered to you. Other than compensation, the only benefit anticipated for your members at this time is health insurance coverage, which county regulations require. Any licensed [REDACTED] can work with you without restriction.

Section 501(c)(4) of the Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Section 1.501(c)(4)-1 (a)(2)(ii) of the Income Tax Regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations that are operated for profit.

Rev. Rul. 68-45, 1968-1 C.B. 259, describes a war veterans' post whose principal source of income is from bingo games open to the general public but whose principal activity is not bingo. In concluding that the organization is primarily engaged in social welfare activities even if it receives a substantial portion of its funds from bingo, the Service emphasized the importance of determining the primary activity as opposed to the primary source of income. A determination of primary activity requires an analysis of all facts and circumstances.

Rev. Rul. 68-46, 1968-1 C.B. 260, describes a similar war veterans' post. After an analysis of all the facts and circumstances, the Service determined that the organization's primary activity was the conduct of a business rather than a social welfare program. The organization rented a commercial building and operated a public banquet and meeting hall with a bar and dining facilities. Although the organization carried on veterans' programs and other social welfare activities, based on an analysis of the whole operation, the Service concluded that the business activities relating to the operation of the facility exceeded all other activities.

Rev. Rul. 61-158, 1961-2 C.B. 115, describes an organization that was created exclusively for the promotion of social welfare but whose principal activity was conducting a lottery on a weekly basis with the general public. Its principal source of income was the gross receipts from the weekly lottery. It used the profits of the lottery for the payment of general expenses and social welfare purposes. The ruling holds that the organization is not operated exclusively for the promotion of social welfare because its primary activity is the conduct of a business for profit. Accordingly, it is not exempt under section 501(c)(4) of the Code.

An organization may promote social welfare by "relieving the burden of government" as one of its purposes. The concept of "relieving the burden of government" is discussed in Rev. Rul. 85-1, 1985-1 C.B. 177, and Rev. Rul. 85-2, 1985-1 C.B. 178. The first case dealt with an organization that was set up to provide funds to a county's law enforcement agency to police illegal narcotics traffic. The second case dealt with an organization that was set up to provide funds to provide legal advice and training to guardians ad litem representing neglected or abused children before a juvenile court. In both cases, the IRS looked at a two part test in determining whether a group actually "lessened the burdens of government." First, the group had to establish that its activities were such that a governmental unit considered them to be its burden. Second, the group had to establish that its activities actually lessen such a burden. Thus, the IRS had to review the facts and circumstances of each case before concluding whether the group had met its burden of "relieving the burden of government". In both cases, the groups met this burden, and so their exemption under 501(c)(3) was granted.

An association of police officers primarily engaged in providing retirement benefits to members and death benefits to beneficiaries of members was held to not qualify for tax exemption as a social welfare organization because the primary benefits from the organization were limited to its members, Rev. Rul. 81-58, 1981-1 C.B. 331. Also, see *Police Benevolent Ass'n. of Richmond, Va. v. United States*, 661 F SUPP. 765 (E.D. Va. 1987). However, please note that the exemption may be available where this type of an association is established and is maintained by, and where the benefits provided are funded primarily by, a government. Rev. Rul. 87-126, 1987-2 C.B. 150.

Rev. Rul. 86-98, 1986-2 C.B. 74, holds that an individual practice association that provides health services through written agreements with health maintenance organizations does not qualify for exemption from tax as a social welfare organization under section 501(c)(4) of the Code. The main functions of M are to provide an available pool of physicians who will abide by its fee schedule when rendering medical services to the subscribers of an HMO, and to provide its members with access to a large group of patients, the HMO subscribers, who generally may not be referred to non member-physicians. M negotiates contracts on behalf of its members with various HMOs, administers the claims received from its members, and pays them according to its

reimbursement agreement. These facts indicate that M is akin to a billing and collection service, and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs. In addition, M does not provide to HMO patients access to medical care which would not have been available but for the establishment of M, nor does it provide such care at fees below what is customarily and reasonably charged by members in their private practices. Thus, M operates in a manner similar to organizations carried on for profit, and its primary beneficiaries are its member-physicians rather than the community as a whole.

In Indiana Crop Improvement Association, Inc. v. Commissioner, 76 T.C. 392 (1981), the organization was the official seed certifying agency for the state of Indiana and conducted a seed certification program pursuant to the delegation of authority by the state legislature. The Tax court found that as the official seed-certifying agency for the state, the organization directly assisted the United States Department of Agriculture in enforcing the standards and procedures established under federal statute. Thus, the Tax Court found that the organization lessened the burden of the government.

An analysis of the information you have submitted shows that the operation of a beachboy concession stand is your primary activity. The primary purpose of your activity is to raise money or make profits which you will use to pay your manager and your beachboys as wages/compensation. You expect to pay \$[redacted] to \$[redacted] /yr. to your Director, [redacted] as manager of your operations. This is approximately 15% of your gross revenues. Also, you expect to pay several of your members compensation for their services as beachboys. Your activities are carried on in the same way as for-profit businesses that operate similar beachboy franchises in the State of [redacted]. You are operated in a manner similar to the organizations described in Rev. Ruls. 68-46 and 61-158 because you are primarily engaged in carrying on a business with the general public in a manner similar to organizations which are operated for profit.

You have an eight member Board, and three of your members are from the [redacted] family. Also, one of your members is your CPA, another is your administrative assistant, and a third is your attorney. These three members are financially interested in your organization, and are therefore not disinterested parties here. Thus, you are effectively controlled by the [redacted] family. You do not have a majority financially independent Board. As previously stated, Director [redacted] is expected to be paid approximately \$[redacted] /yr. - \$[redacted] /yr. for his services as manager. Your operations will result in earnings to your Director via wages. Your activities do not contribute importantly to any independent exempt purpose. Thus, one of your Directors will profit from your organization, similar to activity which occurs in a commercial business.

Also, you have not shown that you can receive Sec. 501(c)(4) status by "relieving the burden of government" as one of your purposes. You have failed to meet the two part test used by the IRS in determining whether you actually "lessen the burdens of government." First, you have to establish that your activities were such that a governmental unit considered them to be its burden. The City of [redacted] rules and regulations merely states that [redacted] are helpful by providing water sports equipment and teaching water safety. (Section One, [redacted] Concessions Rules and Regulations, City of [redacted] Department of Parks and Recreation.) These rules and regulations don't state that this type of service is a burden of government. Second, you have to establish that your activities actually lessen such a burden. You have not done so. You have shown that the city and county of [redacted] consider the importance of non-profit groups by giving them a preference in [redacted] concessions. However, that is far from proving that

providing beach rental equipment is a burden of the local government. There are commercial as well as non-profit [REDACTED] concessions in [REDACTED]. You have failed to establish that you have met either of these tests. Thus, you have not proved that you can receive Sec. 501(c)(4) status by "relieving the burden of government" as one of your purposes.

You are not similar to the organizations in Rev. Ruls. 85-1 and 85-2, supra, because the only basis for your relationship with the state is your contractual relationship. Performance of an activity on behalf of a governmental unit for a fee does not establish a lessening the burdens of government relationship as it is described in the two above cited revenue rulings. As noted above, the facts and circumstances indicate that you are merely engaging in an activity that the state of [REDACTED] has contracted out to the private sector that includes for-profit and non-profit entrepreneurs. Unlike the organization in Indiana Crop Improvement Association, Inc. v. Commissioner, supra, you have not been designated as an official agency of the state pursuant to the delegation of authority by the [REDACTED] Legislature. Therefore, you are not lessening the burdens of government within the meaning of section 501(c)(4) of the Code.

You have not shown how your operations (i.e., renting boats and related beach equipment to tourists on public beaches) will promote social welfare by "preserving the [REDACTED] tradition", or how paying \$[REDACTED] to a small group of retired/injured [REDACTED] will benefit the general population of [REDACTED]. You have not stated with any degree of specificity how the \$[REDACTED] will be spent annually since you have told us that [REDACTED] must carry medical insurance as part of their employment agreement with you, and thus, this insurance will cover these [REDACTED] medical needs. Thus, you haven't shown that you are promoting social welfare as required under Section 501(c)(4).

Where the organization is a "membership" organization, as is the case here, initially its activities are scrutinized to determine whether the activities of the organization are actually the promotion of social welfare or in the alternative merely the provision of benefits to its members. For the reasons listed above, we find that there is a substantial benefit to its members here since wages are paid to various members for beachboy services rendered by them to the organization. Where the activities are primarily the provision of benefits to its membership, a further inquiry is made as to whether the membership is synonymous with the community at large such that the extension of particular benefits through the activities of the organization can be said to be the promotion of social welfare. By doing this inquiry, we find that hiring less than [REDACTED] and paying an unknown number of former [REDACTED] is not enough to promote the social welfare of the city of [REDACTED].

It is our conclusion that your primary activity constitutes the operation of a business with the general public in a manner similar to organizations that are operated for profit. Your operations serve private interests rather than the social welfare of the community.

Based on the above, we conclude that you do not qualify for exemption as an organization described in section 501(c)(4) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after

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[REDACTED]
your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio EP/EO key district office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, EP/EO Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED] T:EO:RA:T:4, Room 3E5
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

[REDACTED]